

ORIGINAL

NEW APPLICATION



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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

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AZ CORP COMMISSION  
DOCKET CONTROL

Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION OF  
ARIZONA TELEPHONE COMPANY, AN  
ARIZONA CORPORATION, FOR A HEARING  
TO DETERMINE THE EARNINGS OF THE  
COMPANY, THE FAIR VALUE OF THE  
COMPANY FOR RATEMAKING PURPOSES,  
AND TO INCREASE RESIDENTIAL RATES AS  
NECESSARY TO COMPENSATE FOR THE  
RATE IMPACTS OF THE FCC'S USF/ICC  
TRANSFORMATION ORDER

DOCKET NO. T-02063A-12-0473

1 Arizona Telephone Company ("Arizona Telephone"), an Arizona corporation, hereby  
2 applies pursuant to A.R.S. § 40-250 and the Commission's Rule R 14-2-103 for a determination  
3 of Arizona Telephone's earnings and the fair value of its investment and requests that its  
4 residential rates be increased as necessary to compensate for the rate impacts of the Federal  
5 Communication Commission's November 18, 2011, USF/ICC Transformation Order ("USF/ICC  
6 Order").

7 **I. BACKGROUND**

8 On November 18, 2011, the Federal Communications Commission issued the USF/ICC  
9 Order. The USF/ICC Order transitions the outdated federal universal service programs and most  
10 inter-carrier compensation systems into a new Connect America Fund ("CAF"). The FCC's  
11 press release characterized the USF/ICC Order as "the most significant policy step ever taken to  
12 connect all Americans to broadband."

1 The USF/ICC Order will reduce inter-carrier compensation rates to zero by July 1, 2020,  
2 for rate of return companies, with limited recovery from customers and partial recovery from the  
3 CAF. The recovery from the CAF will phase out over time at 5% annually.

4 Arizona Telephone is a small rate-of-return regulated Incumbent Local Exchange Carrier  
5 ("ILEC"). Of particular importance to Arizona Telephone and other rural ILECs, the USF/ICC  
6 Order adds new rules that will reduce federal high-cost loop support to carriers by the amount  
7 their flat-rate residential local service rates fall below a specified annual urban rate floor.<sup>1</sup> The  
8 rate floor includes, if any, state subscriber line charges, state universal service fees, and  
9 mandatory extended area service charges. The FCC's order establishes local residential rate  
10 floors of \$10.00 as of June 1, 2012, and \$14.00 as of June 1, 2013, with the floor thereafter being  
11 determined annually by the FCC's Wireline Competition Bureau, based on a nationwide  
12 average.<sup>2</sup>

13 Federal and state support funding are vital to a robust telecommunications network in  
14 high cost areas. To maintain federal loop support, Arizona Telephone and other rural ILECs  
15 must increase local rates to the FCC-mandated residential rate floors. Otherwise, the amount of  
16 federal support funds will be reduced dollar-for-dollar for each customer by the difference  
17 between the existing local rate and the new rate floor. If local rates are not increased, the new  
18 FCC rules will reduce funds coming to the state of Arizona and negatively impact customers  
19 living in high-cost areas in the state.

20 Low customer density makes Arizona Telephone dependent on high-cost federal support  
21 mechanisms. It is important that the company be allowed to increase local rates, to the FCC  
22 determined annual rate floors, in order to maintain its existing federal support. Therefore,  
23 Arizona Telephone requests the Commission to approve local rate increases to the \$14 rate floor  
24 established by the FCC's order.

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<sup>1</sup> 41 C.F.R. § 54.318.

<sup>2</sup> USF/ICC Order paragraph 236 states the most recently available nationwide average local rate from 2008 was \$15.62.

1   **II.    ARIZONA TELEPHONE**

2           Arizona Telephone Company is a corporation duly organized and existing under and by  
3   virtue of the laws of the State of Arizona. Arizona Telephone is authorized to engage in and is  
4   now engaged in the conduct of a general communications business within the State of Arizona.

5   **III.   SUMMARY OF REQUEST**

6           This application is made pursuant to the provisions of A.R.S. §§ 40-250 and 40-367, and  
7   Commission Rule R14-2-103. The Commission last considered Arizona Telephone's rates in  
8   Docket No. T-02063A-12-0302, which resulted in Commission Decision 73575 issued on  
9   November 21, 2012. Decision No. 73575 authorized Arizona Telephone to raise its residential  
10   one-party rates to \$10.00/month, effective December 1, 2012. However, Arizona Telephone  
11   will lose federal support funds if its local rates are not increased to \$14.00 by June 1, 2013. The  
12   rate floor for 2014 and thereafter will be determined by an annual FCC survey.

13          Arizona Telephone is aware that many parties, including the Commission, have appealed  
14   the USF/ICC Order. However, in the meantime, Arizona Telephone and other rural ILECS must  
15   comply with all provisions of the USF/ICC Order and will remain subject to the increased local  
16   residential rate floors and the corresponding losses of federal support funds.

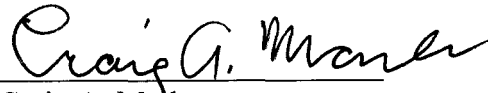
17          Arizona Telephone's loss of federal support funds would be particularly difficult to bear.  
18   As the attached schedules demonstrate, Arizona Telephone's return on investment will still be  
19   negative, even after the December 1, 2012, rate increase is effective. Put another way, Arizona  
20   Telephone's jurisdictional earnings are negative. Losing federal support funds will only drive  
21   earnings deeper into the red.

22          In connection with this application, Arizona Telephone has filed exhibits which include a  
23   schedule of the specific rate changes requested and the impact of the revenue generated on the  
24   company's financial position. Arizona Telephone asks that the Commission determine the fair  
25   value of the company's investments for ratemaking purposes and stipulates to use original cost  
26   less depreciation for those purposes. Because the next opportunity to affect federal support

1 funds is June 1, 2013, Arizona Telephone further asks that the Commission set new rates at or  
2 above the \$14.00 floor to be effective no later than June 1, 2013.

3 To facilitate processing of this application, Arizona Telephone asks that the Commission  
4 waive any provisions of Commission Rule R14-2-103 not required by the Arizona Constitution  
5 and laws.

6 Respectfully submitted on November 23, 2012.


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9

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**Original** and 13 copies **filed**  
on November 23, 2012, with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

By:

  
Craig A. Marks

# **Arizona Telephone Company**

Streamlined filing to support residential rate increase due to FCC  
floor implementation and resulting HCL loss.

October 31, 2012

# Arizona Telephone Company

October 31, 2012

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# Arizona Telephone Company

October 31, 2012

REGULATED RESULTS OF OPERATIONS FOR TWELVE MONTHS ENDING JUNE 30, 2012  
REFLECTS CHANGES EFFECTIVE WITH ARC AND CAF IMPLEMENTATION -- YEAR 1

	TOTAL TELEPHONE OPERATIONS	ADJUSTMENTS	Ref	ADJUSTED RESULTS	INTERSTATE	INTRASTATE
	(a)	(b)	(c)	(d)	(e)	(f)
1 Local	581,156	-5,125 # 8		576,031	0	576,031
2 Universal Service Fund (USF-HCL) and Safety Net Additive (SNF)	166,176	-60,116 #6,7		106,060	0	106,060
3 Access Revenues	2,133,629	-50,630 #12,3,4		2,082,999	1,700,623	382,376
4 Billing & Collecting	24,820			24,820	3,905	20,915
5 Other Misc., Uncollectibles	59,033			59,033	23,397	35,636
6 Total Operating Revenues	2,964,814	-115,871		2,848,943	1,727,925	1,121,018
7 Plant Specific Expenses	741,924	-15,813 #10,13		726,111	351,314	374,797
8 Plant Nonspecific Expenses	407,521	-3,311 #8,12,13		404,210	202,970	201,240
9 Depreciation & Amortization Expenses	1,223,534	1,980 #13		1,225,514	578,743	646,771
10 Customer Operations Expenses	341,596	180 #11,13		341,776	101,401	240,375
11 Corporate Operations Expenses	513,913	660 #13		514,573	183,480	331,093
12 Other Operating Taxes and (Income)	132,415	684 #9,13		133,099	61,895	71,204
13 Nonregulated Adjustment (Part 69 WBI)		-5,676 #13		-5,676	0	0
14 Total Operating Expenses	3,360,903	-21,296		3,339,607	1,474,127	1,865,480
15 OPERATING RETURN BEFORE TAXES	-396,089	-94,575		-490,664	253,798	-744,462
16 State Income Taxes (SIT) (6.97%)	23,197	-57,396 #14		-34,199	17,690	-51,889
17 Federal Income Taxes (FIT) (35%)	-131,467	-28,296 #14		-159,763	82,638	-242,401
18 Total Operating Income Taxes	-108,270	-85,692		-193,962	100,328	-294,290
19 Total Expenses and Income Taxes	3,252,633	-105,988		3,146,645	1,574,465	1,571,190
20 Net Operating Income	-287,819	-8,883		-296,702	153,470	-450,172
21 Total Year-End Rate Base	3,873,823	0		3,873,823	1,478,798	2,395,025
22 Return on Rate Base (Ln 20 / Ln 21)						-18.8%
23 Estimated Revenue from Local Rate Increase						94,752
24 State Income Taxes (SIT) (6.97%)						6,604
25 Federal Income Taxes (FIT) (35%)						30,852
26 Increase in Net Operating Income						57,296
27 Net Operating Income After Increase (Ln 20 + Ln 26)						-392,876
28 Return on Rate Base After Increase (Ln27 / Ln21)						-16.4%

## ASSUMPTIONS

Used 2011 Cost Study run dated 04/30/2012 for Part 36 separately  
Separated results based upon frozen 2000 traffic factors  
Separated results based upon 6/30/2012 financials, interstate rules, adjusted for Part 64 activities  
Working Capital included for all jurisdictions

**Arizona Telephone Company**  
**Adjustments to Revenues and Expenses**

Ref	Account	Description	Debit	Credit
1.	5082200	Access Revenues	482	
	5083000	Access Revenues	243	
	Exclude			725
	To remove prior period (2008) interstate revenue requirement adj.			
2.	5082200	Access Revenues	6,166	
	5083000	Access Revenues	4,168	
	Exclude			10,334
	To remove prior period (2009) interstate revenue requirement adj.			
3.	5082100	Access Revenues	41,948	
	5082200	Access Revenues		53,221
	5083000	Access Revenues	18,790	
	Exclude			7,517
	To remove prior period (2010) interstate cost study true-up.			
4.	5082200	Access Revenues		8,114
	5083000	Access Revenues		4,308
	Exclude		12,422	
	To remove prior period (2010) interstate revenue requirement adj.			
5.	Not Used			
6.	5082110	Universal Service Fund	59,579	
	PPA			59,579
	To adjust for Federal HCL and SN projected change for 2012.			
7.	5082110	Universal Service Fund	537	
	PPA			537
	To remove prior period HCL revenues.			
8.	5001000	Local Revenues	5,125	
	5082200	Access Revenues	30,520	
	5084220	Access Revenues	13,956	
	6540010	Plant Nonspecific Exp		1,638
	Exclude			47,963
	Year 1 FCC Order ICC intrastate and interstate revenue and expense 5% reductions.			
9.	PPA		204	
	7240300	Other Operating Taxes		204
	To remove prior period property tax true-ups.			
10.	6423004	Plant Specific Exp		17,433
	Exclude		17,433	
	To remove one-time write-off of court ordered restitution for damage to TDS cable not received.			



**Arizona Telephone Company**  
**Adjustments to Revenues and Expenses**

Ref	Account	Description	Debit	Credit
11.	Not Used			
12.	6540011	Plant Nonspecific Exp		2,021
	PPA		2,021	
	To remove prior period (2009 & 2010) 499A interstate expense adjustments and DSL FUSC refund.			
13.	6112004	Plant Specific Exp	-	
	6121004	Plant Specific Exp	180	
	6232004	Plant Specific Exp	1,440	
	6532004	Plant Nonspecific Exp	348	
	6561000	Depreciation Exp	1,980	
	6611004	Customer Operations Exp	144	
	6623304	Customer Operations Exp	36	
	6728904	Corporate Operations Exp	660	
	7130000	Other Operating Income	768	
	7240900	Other Operating Taxes	120	
	7990000	Nonregulated Exp		5,676
	To reverse transfer of estimated Part 69 interstate expenses for WBI (Internet) to enable proper Part 36 allocation of total company expenses.			
14.	7220000	Federal Income Tax		28,296
	7230020	State Income Tax		57,396
	PPA		85,692	
	Adjust income taxes to remove prior period amounts and for adjustments to results.			

**Arizona Telephone Company**  
Year 1 Estimated ICC Impact of FCC Order

Base Line of Eligible Recovery:

Interstate SWA (Includes LSS)	Total	5% Reduction	Interstate
Intrastate Terminating Access	610,396	(30,520)	Access Revenue
Recip Comp Revenue	279,114	(13,956)	Access Revenue
Recip Comp Expense	102,501	(5,125)	Local Revenue
Total Base of Eligible Recovery	(32,764)	1,638	Plant Non-Specific Intrastate Local
	959,247	(47,963)	
	AJE #8		

# **Arizona Telephone Company**

Rate Base

As of June 30, 2012

	Total Company	INTERSTATE	INTRASTATE
Plant in Service	\$ 21,239,025	\$ 9,729,997	\$ 11,509,028
Accumulated Depreciation	(17,669,810)	(8,393,883)	(9,275,927)
Net Plant in Service	\$ 3,569,215	\$ 1,336,114	\$ 2,233,101
Plant Under Construction	378,532	173,432	205,100
Material & Supplies	37,316	11,261	26,055
Deferred Income Taxes	(271,187)	(124,952)	(146,235)
Cash Working Capital	159,947	82,943	77,004
Rate Base	\$ 3,873,823	\$ 1,478,798	\$ 2,395,025

Arizona Telephone Company  
For Twelve Ending June 30, 2012

CALCULATION OF CASH WORKING CAPITAL (CWC)

CASH OPERATING EXPENSES	Total Company	INTERSTATE	INTRASTATE
Total Operating Expenses	\$ 3,339,607	\$ 1,474,127	\$ 1,865,480
Less Depreciation & Amortization	1,225,514	578,743	646,771
Cash Operating Federal Income Taxes	(159,763)	82,638	(242,401)
Cash Operating State & Local Taxes	(34,199)	17,690	(51,889)
Total Cash Operating Expenses	\$ 1,920,131	\$ 995,712	\$ 924,419
% LAG (30 days)	8.33%	8.33%	8.33%
TOTAL CASH WORKING CAPITAL	<u>\$ 159,947</u>	<u>\$ 82,943</u>	<u>\$ 77,004</u>

# Arizona Telephone Company

## Proposed Rate Design

2012 June Units

(A)		(B)	(C)	(D)	(E)	(F)	(G)	(H)
Service Description		Jun-12 Units <sup>(a)</sup>	Current Rate <sup>(b)</sup>	Annual Revenues	Proposed Rates	Proposed Revenues	Proposed Change Revenue	Percent Change
<b>Basic Service</b>								
Residence One-Party		1,969	\$ 10.00	\$ 236,280	\$ 14.00	\$ 330,792	\$ 94,512	40.00%
Residence Four-Party		5	\$ 10.00	\$ 600	\$ 14.00	\$ 840	\$ 240	40.00%
<b>Estimated Revenue from Local Rate Increase</b>							<b>\$ 94,752</b>	

### Notes:

<sup>(a)</sup> No reduction made for line loss.

<sup>(b)</sup> Rate filed in pending docket #T-02063A-12-0302

Residential Lines		Year	Type	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2009	One-Party	2009	One-Party	2,888	2,888	2,872	2,865	2,858	2,922	2,927	2,849	2,785	2,718	2,602	2,532
		2009	Four-Party	13	13	13	13	13	13	13	13	13	13	13	12
		2009 Total		2,911	2,901	2,885	2,878	2,871	2,935	2,940	2,862	2,798	2,731	2,615	2,544
2010	One-Party	2010	One-Party	2,502	2,461	2,434	2,404	2,375	2,412	2,405	2,382	2,365	2,334	2,288	2,217
		2010	Four-Party	11	11	11	11	11	11	10	10	10	10	7	7
		2010 Total		2,513	2,472	2,445	2,415	2,386	2,423	2,415	2,392	2,375	2,344	2,295	2,224
2011	One-Party	2011	One-Party	2,195	2,177	2,167	2,154	2,146	2,178	2,169	2,159	2,154	2,125	2,069	2,031
		2011	Four-Party	7	7	7	6	6	6	6	6	6	6	6	5
		2011 Total		2,202	2,184	2,174	2,160	2,152	2,184	2,175	2,165	2,160	2,131	2,075	2,036
2012	One-Party	2012	One-Party	1,993	1,976	1,955	1,942	1,939	1,969						
		2012	Four-Party	5	5	5	5	5	5						
		2012 Total		1,998	1,981	1,960	1,947	1,944	1,974						